THE FREEMAN

IDEAS ON LIBERTY

Educational Freedom

The Fallacy of Comparable Worth

"It's Not Our Money"

Why Regulators Can't Regulate Effectively

JUNE 1986

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Free Trade:
The Necessary Foundation for World Peace

edited by Joan Kennedy Taylor

At a time when public attention is turning to import quotas and other protectionist measures, many voices are being raised in support of the economics of free trade. But there is a deeper, often neglected truth—free trade can help ensure our survival as well as our prosperity. Protectionism can be seen by other nations as an act of hostility that in itself makes international conflict more likely. Free trade, by contrast, deepens the social bonds among those same nations and makes it in their self-interest to seek the peaceful resolution of conflicts.

To place free trade in this larger context of foreign relations, we have mined the back issues of *The Freeman* and other hard-to-find primary sources. Here are fifteen short essays that discuss such thorny issues as world hunger, industrial superiority, industrial unemployment, the American Revolution, foreign investment, the fallacies of economic nationalism, and how free trade protects our national interests. The thirteen authors represented are William L. Baker, Frederic Bastiat, Clarence B. Carson, Frank Chodorov, W.M. Curtiss, Bettina Bien Greaves, Henry Hazlitt, Samuel H. Husbands, Ludwig von Mises, Gary North, David Osterfeld, E.C. Pasour Jr., and Hans Sennholz.

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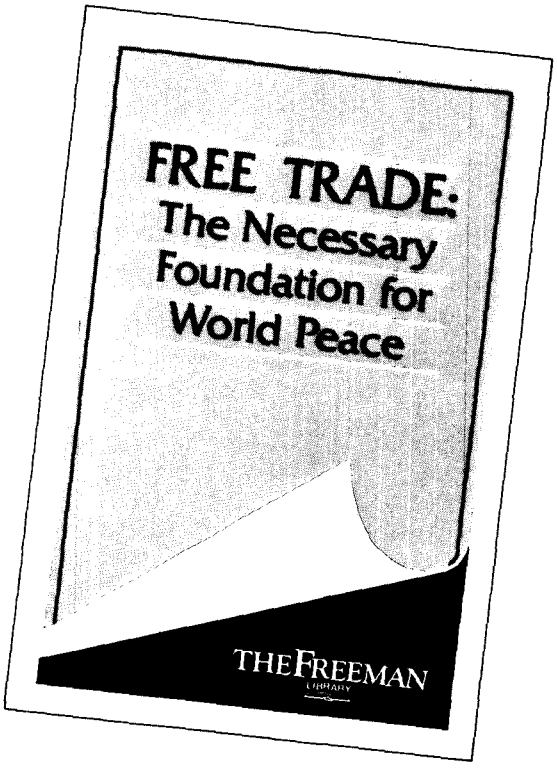

a group of essays that illuminate a single topic. The Introduction for **Free Trade: The Necessary Foundation for World Peace** is by *The Freeman's* publisher, Paul L. Poirot.

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The Freeman considers unsolicited editorial submissions, but they must be accompanied by a stamped, self-addressed envelope. Our author's guide is available on request.

Essay Contest Winners

FEE has long been dedicated to helping people improve their understanding of the freedom philosophy, and their ability to express it in the modern idiom. In this issue of *The Freeman*, we are proud to present the first fruits of a new endeavor to this end—the first-place essays from the 1985–86 FEE student essay contest, "Foundations of a Free Society."

Contestants were asked to "present the positive case for individual liberty and responsibility in a free economy," choosing whatever subject matter they wished within that concept. Accordingly they addressed a wide variety of topics, from abstract themes such as the proper role of government, the meaning of freedom, and the morality of capitalism, to such topical issues as private vs. "public" charity, the problems with American agriculture, and international trade.

The contest drew 184 entries from 36 states, Canada, Argentina, and South Africa. California, Florida, Texas, and Virginia were most heavily represented (thanks, in part, to the promotion efforts of FEE supporters there). Of these papers, 110 came from high school students; 74 from college undergraduates. They were carefully judged by the FEE senior staff.

The main value of such a contest is to provide students with the opportunity and incentive to discipline their thoughts on liberty into written form. Also it helps FEE identify bright young people with a commitment to liberty, whose development we can assist. We have invited the five top entrants from each division to FEE summer seminars at our expense. For the award winners, of course, there is also the benefit of the awards themselves: $1000 to Sarah Lindsey in the high school division, and $500 to second-place winner Mary Jane Massey and $2000 to Peter Heinecke in the college division, and $1000 to second-place

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winner John Majewski. A particular benefit for *The Freeman* is that the contest has been a source of fine articles. We hope our readers will enjoy the work of Sarah Lindsey and Peter Heinecke published herein, and a number of other excellent articles to be published in forthcoming issues.

—HB

A Little Trust

According to newspaper reports, the Greek economy is in a shambles. The government is spending beyond its means, inflating the currency, and borrowing overseas to pay its bills. Prices are rising about 20 per cent each year. Socialist Prime Minister Andreas Papandreou professes to favor "reasonable" profits, but businessmen don't trust him.

Businessmen who want to expand their enterprises hesitate because of state control of some industries, state support of others, and the ever-present threat of increased state regulation. One successful Greek businessman has rejected the prospect of expanding, saying: "If you expand, you hire more people and you have less control over your business. You can't give your people raises and you can't fire them." (*Wall Street Journal*, March 28, 1986)

When government policies lead to economic stagnation, critics blame it on the people, saying they lack energy, initiative, and skills. However, a successful Greek manufacturer of farm machinery, who has turned down the thought of expanding because of the prospects of direct state competition, has a different interpretation: "People say there's no money in Greece. I disagree. People say there's no management skills. I disagree. People say there's no initiative here. I disagree. There's only one thing lacking here, and that's trust."

Many countries now suffer from the same "disease" as Greece—economic stagnation, government intervention, and inflation. It's not that the people lack energy, ingenuity, or skills, but that they lack the confidence which comes from knowing that government will not place obstacles in their way.

—BBG

Let's Pretend

It's a Barnum and Bailey world. At least it is in New York City's South Bronx, where local officials have pasted decals over the windows of abandoned apartments. The decals, paid for by a $300,000 Federal grant, depict curtains, shades, shutters, and flower pots. To a passerby, it almost looks as if the buildings are inhabited.

But, tragically, these buildings aren't inhabited. Forty years of rent control, combined with escalating taxes, have forced New York landlords to abandon thousands of apartments. In the real world, landlords respond to economic incentives—a fact which no amount of decals can paste over.

FEE Columns

In the past few years, articles and reviews by FEE staff members have appeared in *The Wall Street Journal*, *Barron's*, *New York Tribune*, *The Indianapolis Star*, *The Register*, and dozens of other newspapers around the country. In coming months, we will be circulating articles from *The Freeman* and other FEE publications on a more regular basis. If you see one of our articles in your local paper, we would appreciate it if you would send us a clipping.

Reprints Available

We are pleased to offer reprints of John W. Sommer's article, "Disasters Unlimited," which appeared in the April *Freeman*. We also have reprints of James L. Payne's "It's Not Our Money," which appears on page 213 of this issue. Prices are 50¢ each or 25¢ each on orders for 10 or more.

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The Fallacy of Comparable Worth

Why the market best determines wages.

by Peter S. Heinecke

Personal freedom forms the basis of the American political system. Since the founding of our nation, politicians and activists have valiantly fought for freedom of speech, the press, and religion. Yet, one freedom, economic freedom, has been consistently ignored or underestimated. Particularly in recent years, those in power have been willing to abridge economic liberty in attempts to remold society in their vision.

These attempts are dangerous because the free market is essential for both prosperity and true freedom. Attempts to alter the market continually fail because their proponents do not understand the workings of the market. They do not believe people can act beneficially unless coerced by government. They are wrong. America's wealth was not planned by government but created by individual effort. The ability to buy and sell goods and services freely is all that Americans have needed to create a great nation.

A doctrine called comparable worth would end this success. It would have the government tell an employer and an employee engaged in a mutually beneficial relationship that their relationship was illegal. It would have the government prescribe under what terms one person could hire another. It would replace our current successful system of supply and demand with a dangerously unworkable system based on pseudo-scientific studies. It would destroy not only our prosperity but also our liberty.

Proponents of comparable worth claim that it will end a particularly insidious form of discrimination. They claim that the market systematically discriminates against women. They prove this by studying "all" the factors which comprise a job—working conditions, skills needed, and so on—and awarding a certain number of points for each. The sum of these points is the value of the job. Studies of this sort have shown that workers in female-dominated jobs are paid significantly less than workers in male-dominated jobs for work which is of the same "value." For example, in a Minnesota study the job of registered nurse garnered 275 points while that of painter received only 185. The fact that the state of Minnesota paid both equally was seen by comparable worth advocates as *prima facie* evidence of discrimination.

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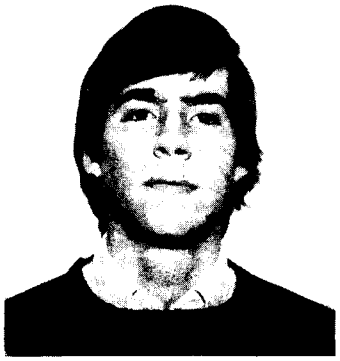

Peter S. Heinecke is the first-prize winner in the college division of FEE's 1985-1986 Freedom Essay Contest. He is a junior at Princeton University, majoring in politics.

Following graduation, Peter plans to pursue a career in business, and perhaps eventually enter elective politics. His family resides in San Anselmo, California.

The solution offered to such "discrimination" is alluringly simple: make it the law of the land that all employers must follow these "objectively" determined worths when creating their pay scales. In the same way that companies are now required to pay men and women equally for the same work, comparable worth advocates would have companies pay workers the same amount if their jobs have the same "economic value."

The essential problem with comparable worth is that its proponents do not understand the relationship between liberty and the market. Wages are not set randomly. Rather, individual choice determines both the supply of and demand for employment. The interaction between supply and demand determines wages. The number of factors in these determinations is infinite because it is based on the personal decisions of all Americans in the workforce. This collective exercise of individual liberty can neither be quantified nor controlled.

Because proponents of comparable worth do not understand this fact, their proposal is plagued by severe logical and implementational flaws. First, the premise that the entire difference in earnings between men and women is due to discrimination is demonstrably false. Second, all extant means of determining the correct pay are hopelessly and inevitably inadequate for such a complex task. Finally, the proposed means of implementing a solution, governmental action, would lead to market chaos and economic fascism. In short, the doctrine of comparable worth is based on faulty assumptions, poor analysis, and unworkable solutions.

Though the feminist movement almost automatically concludes that the disparity between male and female earnings is due to discrimination, the causal link is in fact not so clear. To begin with, studies have determined that between a third and a half of the difference in wages can be directly attributed to differences in education, experience and job tenure. Another important factor is that men and women have different goals and make different career choices. For example, female doctors tend to gravitate toward salaried positions, which allow them more flexibility to raise a family, while male doctors are drawn toward less flexible, but more lucrative private practice. In contrast the wages of presumably career-oriented groups of both sexes are virtually equal. Never-married women with continuous labor force participation receive roughly the same pay for their work as do married, full-time

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working men. And the difference in pay between single men and single women is only 15 per cent. While discrimination may exist, such factors as education, experience, and individual choice are more important in determining wages. Thus, comparable worth is a repressive system which does not address a real problem.

The Willis Scale

Perhaps the best known comparable worth scale is the Willis scale. It was created in 1973 when the state of Washington commissioned the firm of Norman D. Willis and Associates to determine whether the state was paying equal amounts of money to women and men whose jobs required "a comparable level" of skill. It was the basis of a one-billion-dollar court decision against the state.

If the state of Washington is going to pay 1 billion dollars to implement a pay scale according to Willis's guidelines, one would expect those guidelines to be extremely accurate. But they aren't. In quantifying the worth of a job Willis identifies four factors: knowledge and skill required, mental demands, accountability, and working conditions. Each of these factors is divided into two or three sub-categories. For example, under accountability one of the categories is the impact of one's work. Consultants using Willis's manual are advised to award points according to whether the job "impacts on something *big* or *little*, or on something *in between*." It is frightening to think that the state of Washington is preparing to spend 1 billion dollars to implement a pay scale based on one consultant's, or even a group of consultants', inherently subjective interpretation of "*big*, *little*, or *in between*."

Furthermore, the study uses the demands of the job to determine a *monetary* basis for its worth. Yet, many jobs offer intangible benefits which are ignored by the study. For example, such subjective factors as prestige, job security, and opportunity for advancement are often as crucial as monetary remuneration in a person's decision to accept a job. Obviously, it is impossible to quantify these factors and include them in a system. However, to consider money as the only form of remuneration is to subscribe to a fallacious theory of economic determinism. It is to say that employees are only motivated by money. But most employees are smarter than that. Most look beyond salary and enjoy the flexibility of receiving nonmonetary compensation. Comparable worth systems ignore this fact and would invalidate mutually agreeable contracts solely because of salary considerations. Such results demonstrate the unworkable and tyrannical nature of comparable worth.

Another flaw in Willis's study is the equal weighting given to each category. How can anyone say that the education required of a computer programmer is of the same value as the extreme danger faced by a prison guard? Or that the accountability of a high level bureaucrat deserves the same compensation as the mental demands on an air traffic controller? Individuals, of course, make these determinations for themselves when they choose careers. There is no need for the government to do it again. Comparable worth systems would supersede individual preferences and rigidly weigh each consideration equally. That those weightings have no correlation to the reality of individual choice does not seem to bother advocates.

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"Consider a person who has developed the ability to juggle running chain saws. . . . According to any comparable worth scale, this man should be paid as much as a CEO or nuclear engineer."

Thus, at the most basic technical level comparable worth systems are doomed to failure because they are unable to judge accurately those few factors concerning a job which they can identify. This, however, is the least of their problems. There are a multitude of variables which any system is inherently incapable of taking into consideration. The first of these is quality, which the study is forced to neglect because quality can only be applied to a specific person's work performance. The guidelines formed by Willis make no attempt to differentiate between a slovenly, rude, inefficient secretary and a dynamic, innovative, pleasant one. Worse, the competent secretary will always be considered worth less than any third-rate lawyer.

Supply and Demand

The root cause of the above perversions is comparable worth's abysmal inability to consider the most crucial factors in determining the value of anything—supply and demand. No matter how dangerous a job is, no matter how many years of training are required to acquire the skills for it, the job is totally devoid of value if there isn't someone willing to employ a person trained for that job. Consider a person who has developed the ability to juggle running chainsaws. (There is such a person in Venice Beach, California.) Clearly his job requires a great deal of skill, is mentally demanding, is done in varying work conditions, and if there is a crowd around, demands a certain amount of accountability. According to any comparable worth scale, this man should be paid as much as a CEO or nuclear engineer. Yet he survives only on the meager amounts people are willing to toss in his hat. Why? Because there is almost no demand for his services. He performs an almost entirely useless function. But he continues to do it, presumably because he enjoys it. Job satisfaction is another factor which comparable worth scales are inherently unable to measure.

Lest this example seem so extreme as to be a mere aberration, let us look at a more mainstream occupation which pays very little. Buggy whip making was once an extremely valuable skill but you won't find people paid much to do it currently. Why? Because it is no longer needed. Modern technology has made such a skill useless and thus one cannot make a decent wage doing it. Comparable worth, however, does not have any ability to adjust for change. Once a job is determined to have a certain value, it will always have the same value regardless of whether it serves a useful function. To deny employers the right to adjust wages according to changing circumstances will doom our economy to noncompetitiveness in the world market.

A more current example is the pay scale at Weyerhaeuser, a major lumbering firm in the Northwest. A comparable worth survey done by Willis rated the job of personnel manager at 916 and that of a pulp

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mill superintendent at 760. Yet pulp mill superintendents make more money. Why? Because it is difficult to find competent, reliable pulp mill superintendents. Thus Weyerhaeuser pays them a high wage to attract qualified people to that line of work. If the government imposes the wage for pulp mill superintendents, Weyerhaeuser will not be able to function.

Herein lies the basic problem with a government-imposed comparable worth scale: Government-dictated wages will distort and eventually destroy the market. Consider what would happen if the federal government mandated wage increases for workers in female-dominated jobs. First, there would be a flood of people, both males and females, who would be attracted to the lucrative wages in these jobs. Most would end up in the unemployment lines because currently there is no shortage of legal secretaries, librarians, or nurses. Second, the courts would be engulfed with suits claiming discrimination according to the new standards. Because every corporation is different, each suit would require an exhaustive study. The cost of the studies, restraining orders, and retroactive pay increases alone would be a serious drag on the economy.

Scarcities and Surpluses

It would not end there. Eventually someone would realize that if it is unjust to pay women less than their comparable worth, it is undoubtedly unjust and unconstitutional to pay *anyone* less than that person is "worth." Soon the government would mandate every wage paid to every person in the United States. Since there would no longer be any correlation between one's wages and the demand for one's skills, labor would be distributed ineffectively. There would be scarcities of engineers, who don't rate particularly well on Willis's scale yet are in great demand, and surpluses in the suddenly high-paying previously female-dominated fields. Weyerhaeuser would be facing a massive shortage of pulp mill superintendents.

This combination of widespread unemployment and labor shortages in critical positions would result in extreme economic stagnation. Obviously the government would be called upon to resolve such a dire economic crisis. Yet officials would have only two choices: repeal comparable worth laws or coerce people into those areas where workers are needed. It is frightening to think they might choose the latter.

The same market factors which are the nemesis of the advocates of comparable worth are also the solution to the problems they seek to solve. A recent study by the Rand Corporation revealed that in past years women have made great gains with relationship to men in terms of wages. Interestingly, the study indicated that Federal laws prohibiting discrimination were not a major factor in the gains. Rather, as women acquired education, skills, and experience which were in demand, they received commensurate rewards. Furthermore, the study concluded that women would increase their gains in the future for the very same reasons. In other words, women entering the work force today are assessing the situation and, not surprisingly, are acquiring the skills necessary to obtain more lucrative wages. Currently, women have the opportunity to earn as much as men, but because of different goals and values, generally do not. Comparable worth would destroy both their freedom to make choices and their economic opportunity.

Comparable worth derives its political strength from a variety of

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"To impose a price for anything, whether it be a product, a service, or a job, is to suppress people's right to free and mutually agreeable exchange."

emotional, but in the final analysis, irrational arguments. For example, one union official has argued, "When a person whose job requires a college education makes less than a common laborer there's something wrong." Is there necessarily something wrong? Does spending four years of one's life reading books entitle one to a standard of living higher than that of a person who is willing to get his hands dirty and his muscles sore? The answer is yes, if and only if there is a greater demand for, or a smaller supply of, those skills acquired during four years in an ivory tower than there is for the brute force of a common laborer.

The union official's complaint is indicative of comparable worth advocates' inability to grasp one incontrovertible fact: There is no such thing as intrinsic economic value. Money is merely a convenient unit of measurement. Price is merely a reflection of what people engaged in free exchange believe something is worth. To impose a price for anything, whether it be a product, a service, or a job, is to suppress people's right to free and mutually agreeable exchange. Comparable worth, in its attempt to impose an arbitrary and inaccurate notion of justice on the market, denies both men and women the right to exchange freely their goods and services. A woman will not be helped if she is left unemployed because she is barred by the law from taking a job at a wage which she, but not the government, feels is just. The greatest and most tragic irony of comparable worth will be the huge number of people left unemployed because their employers are unwilling or unable to pay artificially high, government-imposed wages.

To sacrifice liberty in a misguided attempt to achieve equality is foolhardy. Governmental determination of wages destroys the source of both America's economic strength and a sense of justice. The free market is not only a tremendous force against discrimination but also the ultimate bastion of individual liberty. It would be a grave mistake to subvert it. It would be folly to think that the federal government once given the power to determine the wage of every worker in this nation would use that power either wisely or effectively. Comparable worth, under the guise of justice, offers us tyranny and economic disaster. We must reject it. □

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Educational Freedom

Only the free market can provide high quality and efficient schooling services.

by Sarah H. Lindsey

The necessity of education, especially in today's rapidly changing society, is still recognized as being of the utmost importance. Yet neither those concerned with the quality of schooling, nor those concerned with individual liberty are satisfied with the current system. It could be argued that the present educational system is inefficient, immoral, and inconsistent with the principles of a free society. In the area of public education, we have failed to separate financing from the production of schooling services. The government, in addition to providing financial aid to education, has also taken on the responsibility for producing educational services. Two things keep the current system working: (1) financing it by compulsory tax payments and (2) the willingness of Americans to accept the belief that there is no alternative to government production of schooling.

Much of the failure in the field of education may be traced to government intervention. One of the first errors was the system's failure to recognize that compulsory attendance would lead to many problems. More specifically, compulsory attendance policies have failed to recognize that some students don't belong—much less want to be—in the classroom. It's assumed that all wants and needs of a student are met by the present educational system. Some students, however, do not want to learn and have no intention of letting others do so. Consequently, they create a disruptive atmosphere for other students and teachers. It is also assumed that all students receive benefits in excess of the costs to taxpayers. To the extent this is not true, compulsory attendance wastes both society's resources and the student's time and is therefore inefficient.

Second, compulsory attendance has lowered the overall standards and quality of today's educational system. The present system is supposedly trying to be fair and equal in its treatment of each student. Yet equality never raises standards; it lowers them to the lowest denominator. This allows even the poorest student to pass graduation requirements. Lower standards restrict ambitious students and high achievers by not presenting a challenge.

Third, through compulsory attendance the State forces parents to have their children associate with uneducable children, juvenile delinquents, and the like. Those who can't afford private schooling or tutors are "locked into" an unsatisfactory situation.

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Sarah H. Lindsey is the first-prize winner in the high school division of FEE's 1985-1986 Freedom Essay Contest. Sarah is a senior at Pennsbury Senior High School in Fairless Hills, Pennsylvania, where she is a member of the National Honor Society. She plans to attend college and will major in either economics or biological sciences.

Sarah has won numerous other awards for her writing and leadership talents. Her non-academic interests include drawing, painting, sculpting, and field hockey.

This leads us to an interesting question: "Does the parent or the State know better the educational needs of a child?" Parents are bound to their children with ties fostered by love and responsibility. Obviously, the parents know better than the State bureaucracy the wants and needs of their child—and should be able to choose the schooling that best suits their child. Yet public schooling deprives parents of this opportunity. The government taxes away parents' income and proceeds to operate the school system as it sees fit.

"As it sees fit" usually includes suppressing the diversity that exists among individuals. A uniform code is imposed on all students, which ignores individual interests and abilities. If the government did not impose a uniform set of rules, however, people would charge discrimination. All people are not alike. Different people have different wants and public school officials cannot please everyone. There will be some parents and students who will not be satisfied with the type of education they receive. Hence, conflict arises between citizens and school boards, between parents and administrators. It is the inevitable result of government decisions rather than private ones.

The last and most powerful argument against the present public school system is that only the free market can provide high quality and efficient schooling services. Letting the market function unhampered in the production of education would likely produce an explosive growth in the number of private voluntary schools. Parents would be free to send their children to trade schools, religious schools, progressive schools, or whatever type for which there was a demand.

Those schools which meet the desires of the customer-parents would flourish. With parents making the choices, schools would have to deliver the kind of education the consumer-parents demand. It would be impossible for a school to avoid the discipline of the marketplace. Schools would be selected on the basis of performance and reputation. Any school that fails to offer what the parents and students want would have to close. If schools had to design their programs with an eye toward the market, society could be assured that everyone's freedom would be broadened by the many new choices that would become available.

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This freedom of choice for parents would also provide real academic freedom for teachers. The market would encourage teachers to improve their professional skills and would stimulate creative persons outside the present system to enter the profession. Teachers would be motivated to improve because they would face competition, not protection through tenure and seniority rules and regulations emanating from the vast, complex government educational bureaucracy. Outstanding teachers would be rewarded with raises if the present employer did not want to risk losing those teachers to another firm. Ideally, teachers' raises would result from quality performance and not from demonstrations or picket-line participation. Those teachers who are incompetent would be either less successful in a market system, or would be "reallocated" by the market to another occupation.

The present public schooling system is clearly inconsistent with the principles of individual liberty and responsibility in a free society. Instead of raising the quality of education, it has resulted in lower standards, conflict, and inefficient use of resources. What the market has accomplished in the production of other goods and services can be realized also for educational services. □

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We need not wait for institutional reform if we wish substantially to improve the education of our young. Not all education occurs in the school. Education, like charity, begins at home. If the task of reforming a giant educational structure serving millions of children seems too large, could each of us at least assume responsibility for the proper mental and moral development of a single child? The individual need not feel impotent when he has before him a task on a scale which he *can* comprehend as an individual, especially when that task is the development of human personality, surely the single most important undertaking in the world.

GEORGE CHARLES ROCHE III
Education in America

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"It's Not Our Money"

Is government a charitable institution?

by James L. Payne

Dr. Payne is on leave as Professor of Political Economy at Texas A&M University.

From time to time the United States House of Representatives lays aside its usual duties to memorialize certain of its members. The tribute is in the form of legislation. A bill is introduced placing the fallen congressman's name on a Federal structure such as a post office or a courthouse, then congressmen rise to speak, extolling the virtues of the deceased and praising his accomplishments.

A harmless ceremony, I thought, as I came across it the other day in the *Congressional Record*. But then something attracted my notice. The representative was praising a former colleague, telling how he had served in Congress with distinction for more than twenty years. The eulogist continued: "As [the congressman's city] grew, he was cognizant of the associated Federal presence which would be required. He continually fought for Federal dollars and was responsible for the construction of the Federal Office Building and Courthouse, the Post Office Terminal Annex, the Air Force Accounting and Finance Center, . . ."

Do you wonder why Federal spending is out of control and deficits drain the economic vitality of the country? You have just seen an important part of the explanation in the words our speaker chose to eulogize his colleague. They betray a distinctive approach to the job of congressman, a view rooted in what may be called the "philanthropic fallacy."

This fallacy makes the assumption that government is a philanthropic institution not fundamentally different from such private benevolent organizations as foundations, churches, or the Salvation Army. Under this view, the representatives are charged with the mission of doing good by spending government funds. The congressman who "continually fought for Federal dollars" is a hero.

Our speaker, eulogizing a different colleague, gave a fuller statement of this misconception, stating that his fellow legislator "always served the people, and his long record in this body indicates clearly the contribution he made for people in the fields of social welfare, housing, and urban development. He worked hard and successfully to use the vast resources of the Federal Government to serve the most in need and to correct injustice."

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The congressman is seen as a philanthropist, using the "vast resources of the Federal Government" for charitable purposes.

It is easy to see that once this view becomes prevalent, holding back government spending becomes next to impossible. For the philanthropist, the only reason to stop spending is to be out of cash, and to have no way of raising more. To have money and yet to refuse to give it to worthy causes marks one as "insensitive" and "hard-hearted." For those in the grip of the philanthropic fallacy, the operative principle for government spending is "more"—no matter how high the level of spending already is.

A Popular View

Congressmen are not alone in holding this view of government as a charitable institution. To a considerable degree, they absorb it from the culture that surrounds them. In our media, we refer to politicians who favor greater public spending on good causes as "compassionate," while those who urge cutbacks are called "heartless." Even our fiction encourages the philanthropic fallacy. Almost by definition, the "good" kings and queens of fairy tales gave large sums to the poor. No mention is made of how they acquired these sums.

In dealing with the philanthropic fallacy, the problem lies not in understanding why it is believed—for it surrounds us practically as the air we breathe—but in reminding ourselves that it *is* a fallacy. The government is *not* a philanthropic institution. It is not even an ordinary agency of production or distribution like a business or a store. It does not create goods and services that citizens voluntarily exchange for their wealth. A government, by definition, is an organization that deploys public force. It deals with pushing and shoving, with coercion.

The dollars a government commands are obtained through the use of force, direct or indirect.

When the government taxes, the use of force is direct: If you refuse to part with the funds the government official demands, he will have you thrown in jail. When the government borrows money, it is still relying on its taxing power. Lenders are reassured by the government's promise to use force to collect the repayment. When the government prints money—thus devaluing the dollars citizens hold—it relies on its ability to outlaw other currencies and force everyone to accept its paper as "legal tender."

Many people find this view unfamiliar, because they fail to inquire where public funds come from. Where, for example, did good kings of old get the resources they were so generous with? Kings didn't *earn* their money. They didn't shoe horses or tend pigs for a living. They sat in castles while their soldiers collected taxes. It was these taxes, taken by force from others, that rulers "gave" away.

Once the proper connections are made, the role of the congressman ceases to appear so philanthropic. Instead it takes on the character of a difficult balancing act. In this light, a congressman's fully translated epitaph might be far from flattering.

"He continually fought to have money taken from his fellow citizens by force for the construction of a Federal Office Building in his district."

This is not to say that appropriations of public funds are necessarily wrong. Some may be of sufficient benefit to outweigh their coercive

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aspect. A congressman would be entitled to say in good conscience, "I support this appropriation because I feel that the value of these funds for X service outweighs the harm of taking these monies by force from our fellow citizens." If X were "national defense," for example, most of us would agree, albeit hesitantly, with the statement.

The philanthropic fallacy is further encouraged by the beneficiaries of public spending. None of these recipients mentions the coercion and injury involved in *raising* public money. Instead, they stress the good that the congressman can do by *spending* it on them. They present their case exactly as they would if appealing to a private individual, inviting the congressman to play the role of a voluntary donor generously giving of his own wealth.

"We thank you for your support in the past," the supplicants say, in closing their testimony, "and look forward to it in the future." What the congressmen should answer is, "Don't thank us; it's not our money." □

LEGAL PLUNDER

IDEAS ON LIBERTY

The war against illegal plunder has been fought since the beginning of the world. The law itself conducts this war, and it is my wish and opinion that the law should always maintain this attitude toward plunder.

But it does not always do this. Sometimes the law defends plunder and participates in it. Thus the beneficiaries are spared the shame, danger, and scruple which their acts would otherwise involve. Sometimes the law places the whole apparatus of judges, police, prisons, and gendarmes at the service of the plunderers, and treats the victim—when he defends himself—as a criminal. In short, there is *legal plunder*.

This legal plunder may be only an isolated stain among the legislative measures of the people. If so, it is best to wipe it out with a minimum of speeches and denunciations—and in spite of the uproar of the vested interests.

But how is this legal plunder to be identified? Quite simply. See if the law takes from some persons what belongs to them, and gives it to other persons to whom it does not belong. See if the law benefits one citizen at the expense of another by doing what the citizen himself cannot do without committing a crime.

Then abolish this law without delay, for it is not only an evil itself, but also it is a fertile source for further evils because it invites reprisals. If such a law—which may be an isolated case—is not abolished immediately, it will spread, multiply, and develop into a system.

FREDERIC BASTIAT
The Law

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Deregulation of the Natural Gas Industry

How the free market efficiently allocates energy resources.

by J.D. Steelman, Jr.

Mr. Steelman practices corporate and commercial law in Tulsa, Oklahoma. He has particular experience in oil, gas, and mineral rights.

No industry has been more heavily regulated than the natural gas industry. From the wellhead to the burner tip virtually every level and aspect of the industry is regulated in minute detail by the state and federal government. Today the industry, like other previously regulated industries such as transportation and finance, is being deregulated and thrust into the competitive marketplace. The result, not surprisingly, is lower gas prices.

In 1848 John Stuart Mill first applied the concept of "natural" monopoly to the gas industry of the City of London and thus began more than a century of gas industry regulation in the English-speaking world. As pointed out by the late Ludwig von Mises and by Murray Rothbard, a "natural" monopoly is merely a limited-space monopoly.[1]

A gas company desiring to commence service to a local market must reach agreement with the owners of the streets and the subsoil for the installation of pipelines and meters. In most instances this means the gas company has to contract for an easement or the purchase of real estate with the local authorities who own or control the streets and real estate through which the gas company must lay its lines. Given the limited supply of land through which the gas company must lay its lines, the local authorities of necessity have to allocate the available supply of real estate which is to be used for the pipeline easements. Thus only one or a few gas companies is normally allocated the land rights within a city in which to lay pipelines. This right is frequently called a franchise.

Local authorities reasoned that granting the gas company or companies a natural monopoly would result in "monopoly" prices. Thus, the local politicians felt compelled to protect the consumers of natural gas by insuring that the gas company's rates were "just and reasonable," a common euphemism for price controls. Controlled prices are not market prices since the dynamics of the marketplace will always tend to make the controlled price higher or lower than the market price, thereby resulting in surpluses or shortages.

As Rothbard points out, every business has a monopoly on the space occupied by that business. Since consumers utilize many subjective factors, including the location of a business, in valuing goods and

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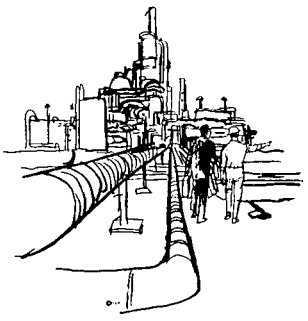
services, it is impossible to determine whether a price premium is due to the spatial monopoly of the business. Monopoly price cannot be conceptually distinguished from competitive price and thus as Rothbard says, "All prices on the free market are 'competitive'."

In 1877 the United States Supreme Court, in a decision extending beyond a mere spatial monopoly, held that a business (grain elevators) could be so affected with a public interest that the state could grant a monopoly to that business and thereby limit competition.[2] This established the philosophical and legal framework for subsequent regulation of American business, including the extensive regulation of the natural gas industry in the thirties.

Until the passage of the Federal natural gas legislation, regulation of the gas industry was purely a matter of local and state concern. It was limited primarily to the granting of franchises and the local regulation of rates. Federal regulation extended only to oil pipelines, and the Supreme Court expressly precluded regulation of interstate natural gas pipelines.[3]



Alleged Abuses

The regulation of the interstate natural gas industry had its beginnings in the early 1920s as a result of alleged abuses by public utility companies. The "abuses" alleged were control of the interstate pipeline systems by a few holding companies, resulting in high prices to the consumer, and domination of the purchase of gas, resulting in low prices to producers.

In 1928 Congress passed a resolution directing the Federal Trade Commission (FTC) to investigate and report on these allegations of public utility "abuses" and to recommend legislation to remedy the "abuses." The FTC found a number of "abuses." The most important ones were (a) the concentration in purchasing and transportation of natural gas, (b) discrimination in the purchases of natural gas from producers, (c) the unregulated competition in construction of natural gas pipelines, (d) costly competition among pipelines and holding companies, and (e) excessive variations in wholesale natural gas rates.

The natural gas industry was experiencing a tremendous expansion during the period covered by the FTC investigation. Large discoveries of natural gas were found in Louisiana, Texas, Oklahoma, and Kansas. At the same time as the natural gas fields were undergoing development, major oil fields having substantial quantities of natural gas were also being developed. The end result of such discoveries was a substantial increase in natural gas supplies in the local and regional marketplace. Prices fell and gas production was shut-in for lack of markets.

As a result of the low prices for natural gas, long-distance transmission line companies saw an opportunity to sell gas in markets that were great distances from the producing fields. At the same time, construction and operating costs for such pipelines were declining due to improved technologies (such as seamless steel pipe which enabled gas to be transported long distances at high pressures), and other efficiencies, while prices for competing fuels were beginning to rise. Thus transmission companies began to purchase the surplus natural gas and transport it to the more distant markets. The natural gas market in the 1920s and 1930s had all the ingredients required for a profitable undertaking in the long distance transmission of natural gas.

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Affected with a Public Interest

Unfortunately, the FTC investigation resulted in Congressional action. In 1935 the Federal Power Act and the Public Utility Company Holding Act were passed into law. Then in 1938 the Natural Gas Act was enacted. The interstate natural gas industry was deemed to be affected with a "public interest" and therefore became a fully regulated industry. Natural gas companies are granted exclusive service areas and market entry is subject to approval of the regulators through issuance of certificates of public convenience and necessity. In exchange the regulators require rates to be "just and reasonable."

The Natural Gas Act, which was administered by the Federal Power Commission (FPC), extended to the transportation and sale of natural gas by natural gas companies. In 1954 the Supreme Court extended regulation to the prices paid by interstate pipelines to independent natural gas producers.[4] Gas being sold in the interstate market was controlled at what proved to be below market prices. Not surprisingly shortages developed in that market. At the same time, the intrastate natural gas market which was not Federally regulated had an abundance of gas.

Under the Natural Gas Act, virtually every aspect of the interstate transportation and sale of natural gas is regulated by the Federal Energy Regulatory Commission (FERC), successor to the FPC. Rates are set on a cost-plus basis. The rate of return is calculated as a percentage of invested capital and is virtually guaranteed once set. Expenses are reimbursed, as are the costs of natural gas supplies, the largest component of a pipeline's costs. In order to increase a pipeline's rates the company must file a rate case. A hearing is held in which customers, suppliers, regulators, and any other interested party may participate. As one might expect, the issues become complex. Resolution of the issues is often difficult, expensive, and time-consuming.

The price disparities between interstate gas and intrastate gas which developed in the mid-1970s and resulted in shortages in the interstate market pointed out the below-market pricing of interstate gas by the Federal regulators. To avoid the loss of sales due to the shortage of natural gas and the increased risk of underrecovery of their fixed costs, pipeline companies actively sought new sources of gas supplies. A favorite inducement to natural gas producers during this period of shortage was the take-or-pay provision in long-term supply contracts in which the purchasers agreed to pay for gas even if they did not take it. Later when the market changed from shortage to a surplus supply of gas, pipeline companies were saddled with this liability under their take-or-pay contracts.

While these unrecovered fixed costs could be theoretically recovered in the next rate case filed by the company, regulators were reluctant to pass on to consumers the take-or-pay liabilities which amounted to tens of billions of dollars. Since industrial and commercial consumers were switching to alternative energy supplies such as residual fuel oil and coal, the pass-on of the take-or-pay liability would only increase substitution of energy alternatives resulting in what became known in the industry as "the deathspiral" which would ultimately lead to receivership. Thus producers and pipeline companies were encouraged to renegotiate their contractual arrangements to reduce the take-or-pay liability.

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The Move Toward Competition

In response to the natural gas shortages which developed during the period 1975 to 1977 in the interstate market the Natural Gas Policy Act was enacted in 1978 for the purpose of gradually deregulating the prices paid by the pipelines for gas (significant deregulation did not start until 1985), thereby encouraging development and production of gas.

In early 1981 the Reagan administration deregulated oil prices. The result was an immediate and sharp increase in prices followed by a dramatic decrease. Fuel oil became extremely competitive with gas. As pipeline companies scrambled to meet the competition of fuel oil they curtailed purchases of gas from producers and other suppliers and renegotiated contracts. This created a surplus of natural gas. The pipeline companies and distributors initiated a number of programs to make natural gas more competitive with fuel oil.

Rather than buy the gas and resell it to industrial consumers, pipeline companies began to transport gas for the producer or industrial consumer. Due to the FERC rate regulations, this means of doing business was not as profitable to the pipeline companies; but because such transportation would help to reduce take-or-pay liability to producers and prevent further sales losses, it became attractive to some companies. Thus by 1984 many companies and producers had voluntarily readjusted contractual relations, and pipeline companies were beginning to carry more gas from producers to industrial consumers. However, producers continued to have a surplus of natural gas.

The Natural Gas Policy Act deregulated approximately 40 per cent to 60 per cent of the natural gas in the United States as of January 1, 1985. The United States Department of Energy's new Import Guidelines of February 1984 and the new Canadian Natural Gas Export Pricing Policy implemented in the fall of 1984 reduced the price of imported Canadian gas by 30 per cent. In the summer of 1984, FERC further deregulated the gas industry by reducing take-or-pay liability between pipelines in what are called minimum bill contracts.[5]

Then in early 1985 the FERC began to advocate substantial deregulation of the natural gas industry to encourage companies to assume greater risks and have the opportunity for greater returns. In the fall of 1985 the FERC formally implemented its deregulation policy and the Department of Energy filed with the FERC to deregulate the remaining categories of natural gas still under price controls.[6]

Industrial consumers began to search in earnest for cheaper gas which more producers were willing to sell. Brokers and marketers, neither of whom are regulated by the FERC, saw the profit potential to be gained from matching producers and industrial consumers. A national clearinghouse developed to broker gas as more pipelines began to carry gas and soon a national spot market began to emerge as the industry became more competitive.

The Competitive Marketplace

In this new era of deregulation, the name of the game in the natural gas industry is marketing and competition. Producers, pipelines and distribution companies are all beginning to respond to the demands of the consumer, especially the large industrial consumers. As in the transportation (rail[7] and air) and financial industries, competition is transforming the way in which the natural gas industry does business and is making it more efficient.

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"The future holds the promise of an industry free at the wellhead, free at the gathering line, generally free and competitive at the transmission line, and much less restricted at the distribution end."

As one industry executive has said, "The future holds the promise of an industry free at the wellhead, free at the gathering line, generally free and competitive at the transmission line, and much less restricted at the distribution end."[8]

Pipelines are beginning to position themselves to be primarily transporters of natural gas rather than merchants. In 1985 a number of interstate pipelines merged in order to expand their markets from regional to multi-regional or national transportation markets. In addition to expanding their markets, the mergers have enabled pipelines to enlarge their supply sources. The natural gas market is becoming a nationwide market for the first time in its history.

Not only have pipelines begun to compete with each other, they also have found themselves competing with national brokers and national marketers. In order to meet this competition, marketing companies have been created by the pipeline companies. The result has been new alternatives for the large industrial and commercial consumer and the distribution companies supplying the residential user.

A new and thriving spot market in which gas is bought and sold on short-term contracts at prices reflecting current market conditions has come into play. The California spot market which has developed into one of the most competitive is just one example. In the words of the president of a large interstate pipeline company, "The spot market is growing by leaps and bounds. There are virtually no barriers to where you can sell gas today."[9]

The future, says another industry executive, "is full of growth opportunities for nimble firms, intensely competitive at the burner tip, and unforgiving of ponderous bureaucracies or strategic errors. The business prizes will go to those who can shed their past intellectual baggage and embrace the new world of natural gas entrepreneurship."[10]

Competition and lower prices eventually would have come to the natural gas industry as a result of lower prices for competing energy products even if the regulators and the legislators had not moved to deregulate the industry. For even regulated companies having exclusive market areas, dedicated supply sources, and guaranteed rates of return are not guaranteed customers or immunity from competition when the prices of competitive products drop significantly below the price of the product of the regulated company.

The marketplace ultimately removes price disparities between competitive products in an effort to efficiently allocate resources. It subjects regulated companies to the laws of economics and the rigors of the market. Absent deregulation, the marketplace would have caused the regulated companies to compete or go out of business. Thus the

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best role for regulators and legislators to play in such a dynamic environment is to encourage maximum flexibility, freedom, and competition by deregulating as quickly as possible, since the most effective and efficient allocation of natural gas resources is through a competitive and free market. □

1. Ludwig von Mises, *Human Action* (Chicago: Henry Regnery Co., 1966), p. 375. Murray Rothbard, *Man, Economy and State* (Los Angeles: Nash Publishing, 1970), pp. 619-620.
2. *Munn v. Illinois* 94 U.S. 113 (1877).
3. 49 U.S.C. § 1(1)(6) (1976); *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co.* 273 U.S. 83 (1927); *Missouri v. Kansas Natural Gas Co.* 265 U.S. 298 (1924); See Garfield and Lovejoy, *Public Utility Economics*, (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1964) pp. 294-350.
4. *Phillips Petroleum Company v. Wisconsin*, et. al. 347 U.S. 672 (1954).
5. FERC Order No. 380.
6. FERC Order No. 436; Notice of Proposed Rulemaking Docket No. RM86-3-000. In late February 1986 the Reagan administration circulated for consideration by Congress proposed legislation to deregulate the remaining categories of natural gas prices which are still regulated under the Natural Gas Policy Act.
7. Henry W. Vanderleest and Karoline Bota, "Railroad Deregulation," *The Freeman*, October 1985, pp. 610-617.
8. Vinod K. Dar, "Resolve Conflicting Interests," *Oil & Gas Journal* (July 1, 1985), p. 24.
9. Robert D. Hershey, Jr., "Scrambling for Profits in a Gas Glut," *New York Times*, December 30, 1984, Section 3 p. 1.
10. Dar, *op cit.*

SOCIALIZED OIL

IDEAS ON LIBERTY

Government intervention in the energy industry has taken a heavy toll in the Soviet Union, Mexico, and other nations. Russia's thriving petroleum industry, rivaling that of the United States at the turn of the century, was devastated by nationalization and Marxist reform. Writing in *Nation's Business* (August 1941), Thomas Read noted: "As to the effect of government control on potential supply, the record shows 20 years of experience with government control in Russia, which in 1900 produced the same amount of oil as the United States, in 1916 produced one-fifth as much, and in 1929 less than a tenth as much."

The promising growth of Mexico's oil industry was hampered by high production taxes and export taxes, and severely arrested by nationalization in 1938. Over the next decade not one new field was discovered, and new development wells failed to keep pace with retired wells. In 1947, for example, 20 wells were drilled in Mexico compared to 9000 in Texas. In the 1950s, U.S. know-how and capital came to the rescue, but large-scale corruption and such inefficiencies as overhiring prevented the great potential wealth of the Mexican petroleum industry from eradicating the country's chronic poverty problem.

In the late 1970s, prolific discoveries confirmed Mexico as potentially a major oil power, but what was hailed as a new era of abundance quickly collapsed because of corruption and inefficiency, high debt, declining world prices, inflation and peso devaluations, and petrodollars misspent on prestigious industrial projects. Excruciating poverty remains.

ROBERT BRADLEY, JR.
(from his forthcoming Cato Institute book,
Oil, Gas, and Government: The U.S. Experience)

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Why Regulators Can't Regulate Effectively

Government regulators face insurmountable knowledge and incentive barriers.

by E. C. Pasour, Jr.

Dr. Pasour is a professor of economics at North Carolina State University at Raleigh.

There is widespread agreement that government price regulation is not achieving its objective—whether the product is milk or electricity. However, there is no consensus as to *why* the results of price regulation are so unsatisfactory. Ralph Nader and consumer groups typically place the blame on the regulators. Others, including some economists, attribute the poor results to lack of resources devoted to regulation. There is a great deal of evidence, however, that larger expenditures by regulatory agencies will not solve the problems of price regulation.

Problems confronting price regulators are similar to those facing central planners of all types. This paper discusses the problems innate in central direction and describes the implications for two types of price regulation.

Economic planners are doomed to disappointment because of incentive problems and information problems.[1] Incentive problems are inherent in the political process because of the separation of power and responsibility. That is, political actors do not bear the major responsibility for the outcomes of their decisions. The incentive problem arises whether decision-makers are elected or appointed.

For the elected official, the next election is a primary concern and actions taken are heavily influenced by re-election considerations. Indeed, political incumbents have manipulated Social Security payments, agricultural price supports, and other government programs in attempts to affect upcoming elections. Politicians generally favor policies where the benefits are immediate and the costs are delayed. This short-run bias in the political process has contributed to the growth of government deficits in the United States during the past fifteen years. Budget-balancing is politically unpopular because the costs to the public are immediate but the benefits occur in the long run when current legislators may be out of office.

Non-elected public officials also have incentives to use the regulatory process to their own advantage. There is no single goal of bureaucrats, but salary, public reputation, and patronage are all associated with size of budget.[2] Thus, it is no accident that government agencies once established tend to grow regardless of changes in economic conditions.

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Information problems also prevent regulators from regulating effectively. These information problems are rooted in the separation of knowledge and power. That is, individuals with decision-making power in the political process do not have and cannot obtain the specialized information about demand and supply conditions known by producers, consumers, and resource owners. Thus, even if government employees were all selfless public servants totally dedicated to the public weal, regulators would be unable to regulate effectively because of information problems.

Opportunity Cost and Entrepreneurship

Consider the problem that arises when regulators attempt to set utility prices on the basis of costs. The decision-maker is influenced by opportunity cost, and the opportunity cost of any action is the value of the sacrificed alternative. The cost of a vacation trip by Jones, for example, is the value he places on the refrigerator, automobile, or other good(s) or service(s) that must be given up if the trip is taken. Opportunity cost is subjective because the sacrificed alternative is not actually experienced. Thus, attempts to set prices on the basis of costs are futile because regulators cannot determine the costs that influence entrepreneurial choice.

Consider the cost of generating electricity in a nuclear power plant. Entrepreneurial expectations are always crucial in cost calculations involving depreciation, interest, and other outlays. Expectations concerning obsolescence, likelihood of closedowns, and so on, however, are likely to vary widely—especially in the case of nuclear power. Thus, the cost and revenue calculations of production processes ultimately hinge on subjective opinions.

Why not set public utility prices competitively on the basis of demand and supply conditions? Focusing on supply and demand does not avoid the problem that the relevant data are subjective. It is not a matter of discovering *the* demand or *the* supply for any particular product. Demand and supply for any product depend upon assumptions made. The amount of product consumers will purchase at any given price, for example, depends upon a number of factors including income, length of adjustment period, and expected prices of closely related products. Similarly, product supply depends upon length of run, expected input costs, expected tax policies, and so on. Thus, differences in expectations about the multitude of factors affecting demand and supply imply a difference of opinion about future product price.

Cost and revenue calculations and entrepreneurial actions ultimately hinge on subjective opinion. Furthermore, in cases in which utility commissions attempt to regulate prices, it is likely to be a matter of differences of opinion. Since entrepreneurial cost and revenue calculations are based on unique knowledge and attitudes toward risk, the validity of over-riding such calculations by the regulator is "dubious in the extreme."[3] Although these theoretical problems are not widely recognized, there is growing disenchantment with the results of conventional approaches to utility regulation and increasing interest in various deregulation alternatives.[4]

A different problem arises when government attempts to redistribute income by *raising product price*—purporting to set product price on the basis of costs, as in farm price-support programs. During the

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Carter Administration, for example, cost of production was specified as the primary guide to be used in setting farm price supports.

However, cost of production is not feasible as a basis for price setting because cost is not independent of price. If government sets the price of (say) wheat above the competitive free market level, profit-seeking wheat growers will bid up the price of wheat land and other specialized resources required to produce wheat. Thus, competition brings about a strong tendency for prices of specialized wheat resources to increase as long as costs, including returns to entrepreneurship, are less than the expected product price. Under these conditions the best estimate of cost of production is product price. Even if the price of wheat were raised to (say) $10 per bushel, prices of wheat land and other resources would continue to increase as long as wheat farming was unusually profitable.

A similar phenomenon occurs when product price is increased by governmental restrictions on entry through the use of land allotments, taxi medallions, and so on. In each case of restricted entry, expected benefits of increased price are incorporated into higher costs so that expected profits of new entrants are similar to those of other investments of comparable risks.

Moreover, the gains to producers arising from government largesse are transitional, accruing to the affected firms when a program is implemented (or benefit level increased). Later producers are not helped because the benefits of higher prices are offset by higher costs. Thus, government programs of this type result in a "transitional gains trap."[5] Once a government program is instituted and the expected benefits incorporated into higher input prices, *all* producers incur windfall losses if the program is terminated.

The preceding scenario is important in explaining the financial plight today of many farmers who purchased land in the late 1970s when agricultural product prices were high. Owners of farm assets generally received transitional gains during this period because of the government's inflationary monetary and fiscal policies. In the heady economic environment of the late 1970s, farmers and other investors recklessly bid up prices of land and other farm assets because of expected favorable product prices and continued increases in prices of farm real estate. As the rate of inflation plummeted during the early 1980s, prices of farm land, buildings and other specialized agricultural resources also decreased dramatically. Once inflationary expectations are incorporated into higher resource prices, government policies that reduce inflation expectations impose windfall losses on owners of specialized resources, just as do reductions in price supports.

Farm programs affect farm asset owners and farm operators differently. Owners of farm assets receive short-run gains either if farm programs are implemented or if benefit levels are increased. However, farmers in their roles as farm operators or farm laborers receive little or no long-run benefits from farm programs. The benefits to farm operators are offset by increased costs. Farm programs also have little effect on returns to farm labor because farm labor readily moves in and out of agriculture. Since competition for labor and entrepreneurial skills tends to equate returns throughout the labor market, the return to labor in the rest of the economy (not farm programs) is the main determinant of farm incomes in the long run.[6]

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Conclusions and Implications

Two reasons have been discussed as to why regulators cannot regulate prices effectively. First, neither the costs nor benefits of regulatory actions are borne mainly by the regulators. Second, even if there were no incentive problem, information prevents public utility commissions and other regulatory agencies from setting price on the basis of cost. Thus, even if regulators have the proper incentives, they cannot obtain the required information to regulate in the "public interest." The highly specialized information of consumers and producers will be most fully utilized in decentralized competitive markets.

Regulators cannot regulate effectively either when they attempt to set price at the competitive level, or when they attempt to redistribute income by raising prices. In the latter case, benefits are incorporated into input prices raising costs to all producers. Thus, gains from government programs to assist producers are transitional and short lived. Moreover, when a price is arbitrarily increased, there is no economic basis for determining what the price *should* be. That is, if a policy benefits some people at the expense of others, there is no objective procedure to weigh the gains and losses in determining whether the policy is beneficial to the public at large. Thus, public policy recommendations ultimately involve value judgments.

The conclusion is that public policy cannot be prescribed on the basis of economic rules. Economic efficiency rules are beneficial to individual decision-makers but these rules, as Hayek emphasizes, are *not* the answer to public policy problems.[7] The data necessary to use economic efficiency rules for policy purposes cannot be obtained by government planners—whatever the policy at stake.

The analysis of public policy issues appears in a different light when incentive and information problems are taken into account and the subjectivity of costs and benefits is recognized. The focus of attention shifts from economic efficiency rules to the institutional framework that provides the greatest opportunity for individuals to cooperate in pursuing their own ends through decentralized coordination of their activities. Much work remains to be done in increasing understanding of the operation of the competitive market process where entrepreneurial activity is fueled by subjectivist expectations. However, no further work is required to show why price regulation invariably fails to achieve its purpose. □

1. Many of the points of this paper are discussed in more detail in the author's paper "Information, Incentives, and Regulation" in *Electric Power: Deregulation and the Public Interest*, John C. Moorhouse, ed. (San Francisco, CA.: Pacific Institute for Public Policy Research, forthcoming).
2. See William A. Niskanen, Jr. *Bureaucracy and Representative Government* (Chicago: Aldine, 1971).
3. G.F. Thirlby, "Economists' Cost Rules and Equilibrium Theory," Ch. 11 in *L.S.E. Essays on Cost*, J.M. Buchanan and G.F. Thirlby, eds. (London: Weidenfeld and Nicolson, 1973), p. 281.
4. A number of regulatory reform proposals are discussed in *Electric Power: Deregulation and the Public Interest*, John C. Moorhouse, ed. (San Francisco, CA.: Pacific Institute for Public Policy Research, forthcoming).
5. Gordon Tullock, "The Transitional Gains Trap." *Bell Journal of Economics* 6 (1975): 671-678.
6. D. Gale Johnson, "The Performance of Past Policies: A Critique," Ch. 2 in *Alternative Agricultural and Food Policies and the 1985 Bill*, Gordon C. Rausser and K.R. Farrell, eds. (Berkeley, CA.: Giannini Foundation, 1985).
7. F.A. Hayek, "The Use of Knowledge in Society," pp. 77-91 in *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948).

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Inflation and Unemployment

How inflation reduces labor productivity and produces unemployment.

by Hans F. Sennholz

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There are many great truths which we do not question every day; we accept them as a measure of knowledge, translate them into action, and pay homage to them by using them. For centuries economists accepted as truth that man's income and wealth are strictly limited by his ability to produce. Economists reflected, not about man's capacity to consume, but about his ability to produce.

Classical economists liked to cite Say's law named after the French economist, Jean-Baptiste Say (1767-1832), who taught that economic production itself generates an income equal to the value of goods produced. There is no reason for fearing surpluses and unemployment because supply generates its own demand. And neither supply nor demand were thought of being capable of causing inflation or deflation. Inflation was attributed exclusively to coin debasement and paper money creation by government during periods of war and civil strife. Once peace was restored inflation was expected to come to an end.

In his *General Theory of Employment, Interest and Money* (1936) John Maynard Keynes rejected this very foundation of Classical economics. He indicted the market order for breeding mass unemployment, and appealed to government for creating conditions of full employment. Demand may fall below supply, which calls for increased government spending, to make up for the lack of demand, or for lower taxes or increases in the stock of money, or a combination of all three.

Keynesian economics postulates a definite relationship between unemployment and inflation. Goods prices remain stable, according to Keynesian theory, as long as there is some unemployment. Inflation raises its head only beyond the full employment mark when demand exceeds supply and no idle resources are available to increase output (demand-pull inflation). The relationship is said to be illustrated by the Phillips curve named after A. W. Phillips, a British economist. As unemployment increases, the rate of inflation decreases; as unemployment decreases, the rate of inflation rises. Conversely, as the rate of inflation is made to fall, unemployment rises; as the rate of inflation rises, unemployment is said to fall. The relationship presents an unfortunate trade-off in which unemployment is the cost of price stability, and inflation the cost of full employment.

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There is No Phillips Curve

There is nothing so elastic as the human mind. Lord Keynes and his followers press it and stress it in order to develop intricate trade-offs and other formulas that indict the unhampered market order and call for government intervention. Surely, politicians and government officials the world over can be expected not only to hail Keynesian recipes for government power as the ultimate revelation of economic wisdom, but also proclaim and celebrate its champions as the thought leaders of our age.

Politicians and government officials depend on Keynesian economists to provide the doctrines of governmental function and power; Keynesian economists in turn can rely on politicians and government officials to bestow prestige, position, and income on their intellectual defenders. As so often in human history, the men of power and the official cast of political thought leaders are led to cooperate for the sake of mutual benefit.

The doctrine of an inverse relationship between inflation and unemployment is a crude generalization of fictitious interaction between inflation and unemployment. It denies basic economic principles, obscures economic knowledge, and contradicts economic reality. Many Keynesians themselves are beginning to wonder whether the Phillips curve really exists.

Actually, the curve contradicts economic thought and experience. Economic records clearly reveal that the age of the classical gold standard was an age of unprecedented monetary stability together with full employment. Goods prices in Great Britain were approximately the same in 1914 as they were in 1851, without the evils of chronic unemployment or much cyclical unemployment. Our 19th-century forebears worked from dawn to dusk and yet enjoyed stable prices and hard money. There was no inverse relationship between inflation and unemployment; no one charted a Phillips curve.

Also, recent experience casts doubts on the existence of a Phillips-curve relationship. A chart drawn for the 1960s differs substantially from one for the 1970s, which again differs from one for the 1980s. The upward shift in the curves indicates that the "trade-off" varies greatly—that is, for a given inflation or unemployment rate the corresponding unemployment and inflation rate is much higher on later charts. In 1963, 1972, and 1974, the unemployment rate was nearly the same, but the inflation rates were 1.6 per cent, 3.4 per cent and 12.2 per cent respectively. Which one is the Phillips relationship? The chartists cannot answer this question because there is no causal relationship between inflation and unemployment that can be charted in any way or form. There is no Phillips curve in real life.

But even if there were such a curve, it would not explain the relations between inflation and unemployment. The chartist who gathers the data and plots the curves would still need to explain the causal relationship. In particular, he would need to answer the question of why there is a trade-off and why it varies continuously, which contradicts the regularity of the relationship. He fails to provide an answer by adding a distinction between unemployment that is frictional, structural, and cyclical. Frictional unemployment is said to arise from voluntary worker movement between jobs. The unemployment that is called structural and cyclical is said to spring from a mismatch between the supply of and demand for labor, especially when total spending

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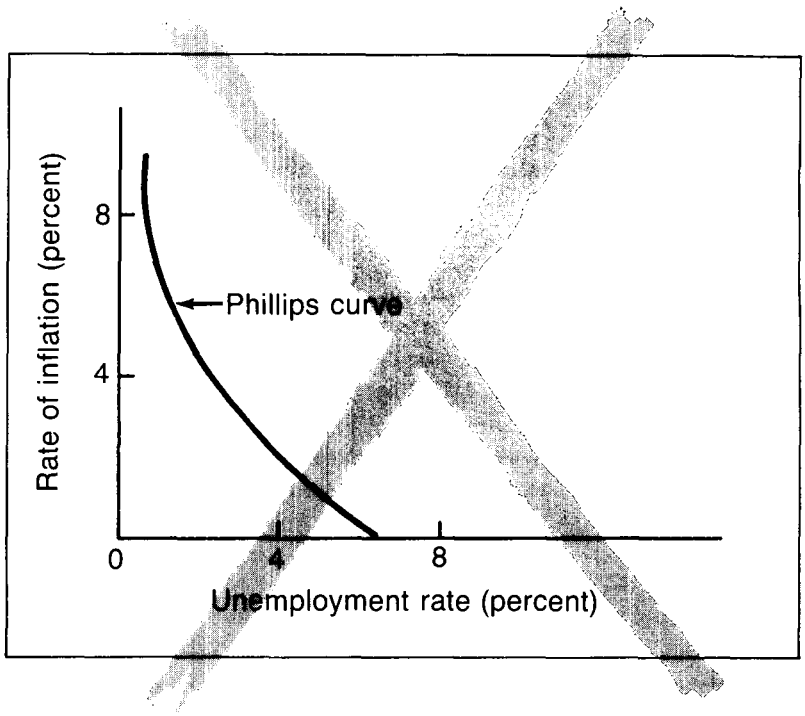

and output fall and the over-all demand for labor declines. The mismatch is to be corrected by governmental intervention of one form or another.

All types of unemployment are said to be subject to the trade-off depicted by the Phillips curve. Most Keynesians are quick to describe and illustrate it; a few try to explain it with vague generalities and references to inflationary forces. During periods of low unemployment when the demand for labor is high, we are told, wage rates are forced up causing goods prices to rise, that is, generating inflation. Conversely, when unemployment rises, wage rates cannot be raised so easily, which causes production costs and goods prices to remain relatively stable.

Such an explanation either fails to explain the relationship or explains it incorrectly. It does not discuss the force that causes wage rates to rise and produce inflation. If there is such a force it needs to be analyzed in all detail so that we may understand it and correct it. Merely to chart it and describe its effects and then recommend a dose of inflation and credit expansion is to escape economic reasoning. It also avoids the important questions of why and how a wage force of any kind can cause all goods prices to rise and inflation to raise its head. Can workers actually bring about inflation that depreciates the monetary unit year after year until nothing is left? Keynesians refuse to answer; in fact, they seek to escape economics by pointing at totally unrelated factors for the changing trade-off, such as a worker's age and sex.

Why is the unemployment rate corresponding to a given inflation rate much higher today than in the past? We are told there are more women and teenagers in the labor force, experiencing discrimination and suffering more unemployment. Moreover, having experienced more inflation during the 1970s people have come to expect more inflation during the 1980s. The Keynesian thus beats a hasty retreat from

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Inflation breeds economic evil and social disorder, and generally erodes the moral and social fabric of a free society—and all this for the sake of deceiving some workers.

the abstract world of economics to the safe ground of psychological and sociological understanding to rejoin politicians and officials for further deliberation on legislation and regulation. He places his trust in political force rather than economic principle.[1]

Deceit Is a False Road

If Keynesians were more receptive to orthodox economic knowledge they would know of the direct relationship between the demand for labor and its cost, between unemployment and gross wage rates. Employment is a function of labor cost and labor productivity. Unemployment always appears when labor cost exceeds labor productivity, creating an excess supply of labor over demand for labor.

Unemployment is a pricing phenomenon as is the surplus of any other economic good. There is no direct relationship between inflation and unemployment. Inflation willfully conducted by monetary authorities causes a rise in the prices of all products and services. If, at times, the rise in labor cost lags behind the rise in product prices, real wage rates decline, which causes the demand for labor to rise and institutional unemployment to fall. This is why Lord Keynes and his followers favor inflation and credit expansion as a suitable method for reducing unemployment. In the Keynesian system workers hopefully do not realize that their wages are reduced and, therefore, in Keynes' own words, do not resist "a gradual and automatic lowering of real wages as a result of rising prices."[2]

A government that practices concealment or deceit in matters that should be fair and open as day destroys public confidence and trust. Deceit is a false road to anything, including full employment. It does not work, especially not in such plain matters as the cost of living which every housewife is watching and appraising every day. Workers who are determined not to suffer reductions in their real wages cannot be led to suffer reductions through deceit. In fact, it is easier by far for government to deceive itself without perceiving it, then to deceive the people without their finding it out.

To practice a little deceit, which works only on simpletons and fools, the Keynesians propose to resort to inflation which is one of the worst economic calamities and social evils. Its effects are ominous and calamitous. Inflation benefits politicians, officials and entitlement grantees at the expense of producers, and enriches debtors at the expense of creditors; it creates a massive flow of unearned income and inflicts undeserved losses.

Inflation consumes productive capital, lowers labor productivity and wage rates, and destroys the middle class that saves and invests in monetary instruments. It generates the business cycle, the stop-and-go, boom-and-bust reactions of business. It invites government controls over prices and wages and other restrictive policies. In short, inflation breeds economic evil and social disorder, and generally erodes

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the moral and social fabric of a free society—and all this for the sake of deceiving some workers.

Economists do not invoke inflation in order to alleviate some unemployment. They go directly to the cause and seek to eradicate it or at least reduce it. Shunning such metaphoric terms borrowed from physics as frictional and structural, they distinguish between voluntary joblessness and institutional unemployment. The former may reflect a voluntary, temporary withdrawal of a worker from the labor market or result from changes in the market process to which he needs to adjust. This kind of unemployment may occur especially in a productive, prosperous society in which the individual may be able to unwind occasionally and take a vacation before he embarks upon new opportunities.

Extraneous Force

Institutional unemployment is involuntary unemployment. Its proviso and requisite is extraneous force that creates an excess of labor over the demand for labor. It is impossible and inconceivable in an unhampered labor market. But it appears wherever extraneous force disrupts the smooth functioning of labor markets. By rendering some labor uneconomical, force makes it unemployable.

In final analysis, government is the only extraneous force that can interfere with the purchase and sale of labor. It does so through labor laws and regulations, taxes, levies, and other exactions; through permits, licenses, and franchises; through deficit spending, inflation, and credit expansion; it may even impose price and wage controls. Politicians prescribe the intervention, judges confirm it, and armed policemen enforce it.

In recent decades governments the world over have delegated some of their coercive powers to labor unions. Labor law and regulation tolerate union violence within broad limits. They permit unions to inflict bodily harm on strikebreakers and employees who engage them, to damage their property, and even injure customers who patronize them. The police rarely interfere with the offenders, public prosecutors do not charge them, and judges do not judge them. In general, government is unwilling to interfere with the actions of labor unions, which grants them coercive powers over large segments of the labor market.[3]

Institutional unemployment may spring from two basic sorts of intervention. Force may be used to *raise labor costs* above the rates an unhampered maket would establish. Or it may be used to *lower the productivity of labor* through taxation, regulation, and inflation. Both government and unions freely resort to both forms of restraint in countless different ways. Workers who refuse to concede to prompt wage reductions face unemployment.

Most politicians and government officials actually believe that they have the power to raise wage rates and confer fringe benefits. Trusting in the might of the courts and police they mandate minimum wages that exceed unhampered market rates, grant social security benefits and impose numerous other costs that mean to benefit workers. In boom and recession politicians foist themselves upon the labor market, raising the cost of labor by boosting unemployment compensation, liberalizing worker's compensation, and passing the costs on to employers. In many industries fringe benefits now equal or even exceed the cost of payroll. Unfortunately, to force a worker's cost above the

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value of his contribution is to render him uneconomical and, therefore, unemployable. Every time government mandates higher labor costs it renders some labor "unproductive" and causes it to be unemployed.

The effects are similar when the productivity of labor declines for any reason and workers refuse to suffer instant reductions in pay. Reduction in labor productivity, after all, raises the unit cost of production in the same way as a mandated boost in cost. It may result from any number of government interventions, union actions, worker attitudes, and even public choices and preferences. It may be inflicted by politicians and government officials who render labor less productive through onerous taxation and myriad regulations. It may be the intentional objective of the workers themselves who, acting in concert as a union, choose to work less and demand more, who impose more work rules that boost costs, or even halt operations by calling a strike. And finally, labor productivity may decline due to changing aspirations, values, and customs on part of the public.

A society that chooses to live beyond its means, that consumes more than it saves and invests and, therefore, reduces the amount of business capital invested per worker, causes labor productivity to decline. Inevitably, it experiences reductions in labor conditions and standards of living and, if wage rates are not permitted to adjust promptly to the decline, is liable to suffer mass unemployment. Unproductive labor tends to be unemployed no matter how it became unproductive.

Inflation Lowers Labor Productivity

Among the many strategems of government intervention that reduce labor productivity and produce unemployment, inflation is one of the most harmful. It is so potent that, in the end, it may play havoc with labor markets, shatter labor productivity, and destroy millions of jobs. Indeed, there is nothing more conducive to unemployment than a policy of willful inflation.

Inflation erodes and consumes capital and hampers its productive employment. It falsifies economic calculation and accounting and causes businessmen to make costly mistakes. Inflation permits government to exact more taxes from business, especially by denying inflation adjustments. When businessmen are forced to ignore inflation, to depreciate plant and equipment only on the basis of past cost rather than current cost, they are made to understate production costs, overstate business profits, and pay higher taxes. In fact, they may be forced to show profits where there are none, and pay income taxes without income—even on losses.

Inflation tends to create illusions of income and wealth that tempt people to raise their levels of consumption. When stock and real estate prices soar a feeling of success and prosperity may seize investors and induce them to buy expensive automobiles, build beautiful mansions, patronize the arts, contribute more to charities, or seek more recreation and pleasure. Blinded by soaring prices and deluded by inflation profits, they are actually consuming their capital.

Similarly, employers are likely to yield readily to unionized labor routinely demanding more pay for less work. After all, the income statement supports the illusion of rising profits and growing wealth, and reinforces the expectation that rising prices will soon cover union demands. This management attitude, especially with "professional management" that lacks ownership interests, may explain the fact that

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Monopoly power over money conceives the power to inflate, which gives rise to the power to boost wages, grant fringe benefits, reduce labor productivity, and cause unemployment, which in turn reinforces the power to inflate.

wage rates in unionized industries, such as steel and automobiles, exceed by far the rates in open labor markets. When the inflation finally comes to an end, at least temporarily, and a recession settles over commerce and industry, disaster is bound to happen. Unionized industries suffer staggering losses, and millions of faithful union members lose their jobs.

Redirecting Business Capital

Free and open industries cope with inflation more smoothly and efficiently without suffering the pains of crisis and unemployment. When labor productivity declines real wage rates are quickly reduced. Surely, this may be hidden by the veil of inflation that causes all prices to rise. But prices do not rise evenly and simultaneously; wage adjustments tend to limp behind the rise in goods prices, causing real wages to fall. For example, when goods prices rise by ten per cent, wages may be raised by five per cent, which reflects a real pay cut and prompts adjustment to falling labor productivity. Workers suffer reductions in real income, but need not worry about the readjustment crisis and loss of jobs that characterize unionized industries.

Many writers are convinced that a little inflation is beneficial not only to business but also the public at large. They argue that wage rates tend to rise more slowly than goods prices, which shifts income from workers to employers and turns wages into profits. In time, the profits are said to be invested in business capital, bringing improvements to labor productivity and worker income. Unfortunately, economic reality differs materially from this version of inflation theory. The reduction in labor costs may be offset by boosts in capital costs as interest rates are likely to rise; it may be offset by a rise in the cost of material and supply and, last but not least, by new exactions of government. Surely, there are many businessmen who hope to profit from inflation, but very few actually do.

Chronic inflation discourages saving and investing and, in the end, may generate a "flight into real values." It may cause commerce and industry to redirect their efforts from consumer service and satisfaction to personal survival. Working capital may be turned into gold, silver, or other precious metals; money and claims to money may be exchanged for machinery and equipment that are not needed but hopefully retain their value. Businessmen may invest in land, which may be illiquid and rather unproductive.

Such a redirection of business capital, which may prove to be highly productive for purposes of survival, usually takes the form of withdrawal from production for the market. Or, it may mean redirection

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of facilities from more efficient uses for which they were meant, to less efficient uses made advisable by the inflation. In every case it lowers labor productivity; in situations of hyperinflation it virtually destroys it. If in such situations the cost of labor is prevented from adjusting to the fall in labor productivity, institutional unemployment is bound to follow.[4]

The productivity of labor may be depressed further by the workers themselves. Undoubtedly, they resent the economic stagnation and decline in income, although they themselves may favor the inflationary policies that prompt the decline; as voters they may cast their votes for politicians who promise yet easier money and credit. Workers may not understand the significance of such policies and their effects on labor productivity and income. Under the influence of popular notions and union dogma, they are quick to ascribe any reduction in pay to employer greed and management incompetence, which does not make for amicable labor relations.

In frustration and anger, some workers may loiter, hold back production, resort to sabotage, or walk off their jobs. Their reaction may be instinctive and understandable; nevertheless, it compounds the fall in labor productivity and aggravates the pains of unemployment. In the end, inflation causes millions of workers to be unemployed, and more millions to be alienated, angrily protesting against the stagnation and deterioration of conditions and marching in picket lines that add to the unemployment lines.

Inflation is a primary cause of unemployment. And yet, learned men and reputable advisers prescribe it, and powerful politicians and officials apply it as a cure for unemployment. In the name of "full employment" they create money and credit that generate the business cycle, misdirect human labor, reduce the productivity of labor, and create mass unemployment.

Inflation is a primeval evil that breeds many other evils. Springing from government power over money and credit and from legal-tender force, it breeds ever more government power that is to alleviate the evil consequences of earlier power. Monopoly power over money conceives the power to inflate, which gives rise to the power to boost wages, grant fringe benefits, reduce labor productivity, and cause unemployment, which in turn reinforces the power to inflate. The consequences lend new strength and support to the cause, in a vicious circle of inflation and unemployment. The circle will end when man rejects all such powers and proclaims his freedom. Man is in the best condition when he is free. □

1. Cf. Lewis C. Solmon, *Economics*, 3rd ed. (Reading, Mass.: Addison-Wesley Publishing Co., 1980), p. 323 *et seq*.
2. John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York: Harcourt, Brace and Co., 1936), p. 264.
3. W. H. Hutt, *The Strike-Threat System* (New Rochelle, N.Y.: Arlington House, 1973), p. 252 *et seq*; Patrick M. Boarman, *Union Monopolies and Antitrust Restraints* (Washington, D.C.: Labor Policy Association, 1963), p. 64 *et seq*; Edwin Vieira, Jr., *Of Syndicalism, Slavery and the Thirteenth Amendment* (reprinted from The Wake Forest Law Review, Vol. 12, No. 3, Fall 1976).
4. Hans F. Sennholz, *Age of Inflation* (Belmont, Mass.: Western Islands, 1979), pp. 33-39.

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Privatization Further Down the Road

A new era of private roads may be close at hand.

by Daniel Klein

Daniel Klein is a fellow of the Austrian Economics Program at New York University.

Private ownership of "public" resources may be an idea whose time has come. There are proposals for the privatization of Grand Coulee Dam, National and Dulles airports, Conrail, and Amtrak. State and local governments are studying private urban transit, garbage collection, and prisons. If privatization maintains its momentum, we will have to consider a logical candidate: the roads.

The best way to understand the notion of private roads is to examine the literature on America's own era of private turnpikes. In 1821 there were over 4,000 miles of private roadway in the state of New York. Between 1792 and 1840, some 230 New England turnpike companies built and operated 3,800 miles of road. It was private enterprise that really got the show on the road in America.

In early America, routes had not been beaten through the wilderness, and roads were sorely needed. People wanted to move westward, and commercial interests in the coastal cities sought to tap the trade of distant areas. State and local governments instituted feeble systems of mandatory labor and taxation to provide roads, but their failures were manifest.

In the 1790s, the road business was opened up to private enterprises throughout New England and the mid-Atlantic region. Private turnpike companies constructed and operated their own roads. They were equity financed and operated for profit. User payment was made at tollgates along the route. No government financial assistance was made, except in Pennsylvania (where 30 per cent of total turnpike stock was held by the state) and in New Jersey (where a small amount of aid was given to the Newark Turnpike Company).

Between 1795 and 1830 turnpike construction was brisk, crisscrossing the Northeast with private roads. During the same period, public construction virtually ceased. In New York between 1790 and 1821, for example, the state's expenditure of $622,000 on the construction of roads and bridges is dwarfed by the investment in similar private concerns: $11 million in turnpike companies and $850,000 in bridge companies. A mixed system of private and public roads emerged.

Not only did private enterprise boost road mileage in America, it

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greatly improved the qualities of the country's roads as well. As the leading transportation historian B. H. Meyer stated, "It is evident that the turnpike movement resulted in a very general and decided betterment of roads."

Although the turnpikes were private, the government maintained tight control through heavy regulation. Most important were the limits on tollrates and the restrictions on the placement of tollgates. These regulations made turnpike profits practically nonexistent. It wasn't long before everyone knew that there was no money to be had by way of turnpike dividends.

Despite the poor direct returns that resulted from government interference, turnpikes still found enthusiastic support for the indirect benefits they conferred. Local merchants, farmers, and landowners bought turnpike stock because the turnpike would make their businesses, produce, and holdings more valuable through improved transportation.

During the mid-1800s the state governments brought the era of private roads to a close by gradually reclaiming control of the roads, although a few private turnpikes survived into the 20th century.

Technological Advances

What lessons can we draw from America's experience with private roads? Clearly, with today's technology, road provision through private enterprise could be even more successful. Electronic metering devices could make stopping at tollbooths obsolete. In Hong Kong, Japan, and elsewhere authorities are experimenting with tamper-proof electronic plates, the size of cassette tapes, which are placed on cars. The plates interact with equipment built into the road surface to register the driver's toll, which he pays through the mail. If this system is feasible, private enterprise could provide roads as easily as it does movie theaters.

Think about recent advances in technology: personal computers are quickly becoming household items, as are laser compact disc units; supermarket cash registers now speak to us; automatic teller machines handle our banking; innovation in motion pictures and television is rampant; Blue Cross now issues credit card-sized "Lifecards" that can contain the equivalent of 800 pages of medical information; air travel has become a casual matter for the middle class; new automotive dashboards look like something from outer space.

Now think about the roads you drive on: How much improvement have you seen in the past fifteen years? How much to you expect to see in the next fifteen? Nil, in both cases. The reason: government control.

Private roads may sound far-fetched, but a familiarity with American history casts the idea in a different light. There was a period when private enterprise was able to provide such "public goods." Private turnpikes engendered important social benefits even though returns on investment were small, primarily due to legal restrictions on toll rates and on the placement of toll houses.

The idea of privatizing the roads is beginning to be taken seriously. Even the federal government's National Research Council is holding a conference this summer on "Roles of Private Enterprise and Market Processes in the Financing and Provision of Road Services." The future may be closer than we think. □

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Mariano Moreno of Buenos Aires

by John Chamberlain

What do we know about Latin American history? Maybe a thing or two about Simon Bolivar and San Martin, the generals who led the forces that freed much of South America from Spain in the early Nineteenth Century. Bolivar might be called the Latin George Washington, and San Martin the equivalent, say, of General Nathanael Greene. But who were the Latin American James Madisons, John Jays, and Alexander Hamiltons? If they left any Latin version of the Federalist Papers we in North America don't know of it.

Ellen Garwood, the daughter of Will Clayton, the cotton broker who was primarily responsible for the Marshall Plan, has done something to dispel our general ignorance of the Latin American past in a first-rate biography of Mariano Moreno, who was Secretary of Government and of War in the 1810 revolutionary junta in Buenos Aires. Moreno, a passionate believer in free markets, had worked for free trade on behalf of the Argentine gauchos before he himself became a revolutionary.

Ellen Garwood calls her biography *The Undying Flame: Mariano Moreno of Buenos Aires* (Washington, D.C.: American Studies Center, 229 pp., $14.95). It is noteworthy that Mrs. Garwood's extensive bibliography contains the merest smattering of Anglo-Saxon names. Mariano Moreno has no entry in my *Encyclopedia Britannica,* which speaks of a "creole" junta in the La Plata region of Argentina. "Creole" was the accepted word for anyone of Spanish extraction who happened to be born on the American side of the Atlantic.

Moreno resented the implication that "creoles" were less deserving of high office in the colonial governments than the Spaniards who went out from Spain to enforce strict mercantilist regulations. (Gaucho hides, tallow, and meat had to be sent to Cadiz and traded for Spanish goods or Spanish coin.) But, like all the early seekers for a relaxation of the mercantilist rules that kept British ships and British goods out of Latin ports (and incidentally set things up for smugglers), Moreno was at first loath to cut completely free of the ties to Madrid.

The Latins faced a situation that was a bit different from the one confronting George Washington, Thomas Jefferson, and John and Samuel Adams in North America. There was the special problem of the captive King in Spain. Napoleon had taken Ferdi-

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nand VII captive. The creoles had ideas about bargaining with Ferdinand, and some of them hoped that a restoration in Spain, once Napoleon was out of the way, would let the new principles of Adam Smith take over.

Ideas of Rousseau

Moreno was the first to discard the "mask of Ferdinand" in the La Plata region. In his *Gaceta,* or gazette, he pushed the ideas of Rousseau, who believed in the social contract. He argued that the authority of the Monarch had been returned to the peoples of both Spain and the colonies through the captivity of Ferdinand.

"The people can," he said, "modify or reduce . . . authority to the form most agreeable to them in the act of entrusting it to a new representative . . . the Laws of the Indies were not made for a State and already we are forming one."

The Argentineans of the La Plata region, in response to Moreno's urgings, opted for a constitution. His trust in the Rousseauistic "general Will" assumed a consensus throughout the whole back country of the Argentine pampas. He had gone to the university in Chuquisaca, where he took degrees in both canonical and civil law. Chuquisaca was leagues away from Buenos Aires, and Moreno was sure that the country he had passed through by foot, horseback, and coach to go to school was with him in wanting a constitution. He sent troops to the back country not as conquerors, but as persuaders.

He did, however, feel constrained to order the execution of a handful of dissenters including a former viceroy, the Frenchman Liniers. This was one of the hardest things that Moreno, a peace-loving man who had been destined for the church before shifting to the law, ever had to do. It brought him the entirely false reputation of being a "Jacobin," which provided a handle for those in the junta who wanted more pomp and ceremony than Moreno felt was compatible with true democracy. Eventually the junta became the creature of its president, Colonel Saavedra, who liked to ape a viceroy's manners even though he stood by the revolution in the end. The Saavedra partisans ultimately pushed Moreno into undertaking a mission to England which was a thinly disguised way of sending him into exile. Worn out by his efforts to prepare the way for the coming of General San Martin, who put the necessary military muscle into the freeing of Argentina and Chile, Moreno fell sick at sea and had to be buried beneath the waves in his early thirties.

Moreno, on Mrs. Garwood's showing, was a truly selfless man. He took legal cases, including one for the gauchos of the pampas, with no thought of personal emolument. He founded the Public Library of Buenos Aires. Public hygiene was one of his preoccupations: he started what became a permanent establishment for the propagation of vaccine. He ordered police patrols in dangerous vicinities, and he insisted on the elimination of potholes in the streets. He was a very practical man.

As a publisher of Rousseau's *Social Contract,* Moreno eliminated the last chapter for reasons of religious scruples. He thought Rousseau had gone astray in religious matters. He seems to have been unacquainted with Rousseau's compatriot Montesquieu. Maybe it was Moreno's cardinal error to have gone to Rousseau for his inspiration instead of Montesquieu, who subordinated the general will to the separation of powers. There admittedly must be some consensus in government, but the gateway to tyranny is opened when there is no provision for vetoes and the constitutional protection of minorities.

With no checks and balances in government it is all too easy for a strong man to assume that he is the embodiment of the general will. □

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Democratick Editorials: Essays in Jacksonian Political Economy
by William Leggett

compiled, edited, and with a foreword by Lawrence H. White
Liberty Press, 7440 North Shadeland, Indianapolis, IN 46250 • 1984 • 412 + xx pages, $12.00 cloth; $6.00 paperback

Reviewed by Arthur A. Ekirch, Jr.

William Leggett, spokesman of the radical, laissez-faire wing of Jacksonian democracy, deservedly continues to attract the attention of modern libertarians. Less than forty years of age at the time of his death in 1839, Leggett in the last decade of his short life became a free-wheeling journalist and newspaper editor, serving from 1829 to 1836 as William Cullen Bryant's assistant, and then partner, on the New York *Evening Post*. Leggett's own forthright editorials in support of equal rights and minimal government caused his newspaper to lose most of its political patronage advertising. Although Leggett therefore, not surprisingly, left the *Post*, he continued to write in two new periodicals of his own, which he promptly established, the New York *Examiner* and the *Plaindealer*.

Lawrence H. White's new Leggett collection draws much of its material from those *Plaindealer* editorials which were not included in the original *Collection of the Political Writings of William Leggett*, published in 1840. White's selections accordingly provide a fuller account of Leggett's running literary battle against all economic monopolies, his support of the divorce of government and banking, and his advocacy of free trade. These causes reflected in large part the national policies of the Jacksonians. And one of Leggett's key editorials, "True Functions of Government," appropriately began with a quote from the President's message, vetoing the recharter of the Bank of the United States: "There are no necessary evils in Government. Its evils exist only in its abuses. If it would confine itself to *equal protection*, and, as heaven does its rains, shower its favors alike on the high and the low, the rich and the poor, it would be an unqualified blessing." "Governments have no right," Leggett added, "to interfere with the pursuits of individuals, as guaranteed by those general laws, by offering encouragements and granting privileges to any particular class of industry or any select bodies of men, inasmuch as all classes of industry and all men are equally important to the general welfare and equally entitled to protection."

On the state level, Leggett's considerable influence among his fellow New York democrats left a legacy of free banking legislation and a general incorporation law. As a follower of the Jeffersonian agrarian or Jacksonian small capitalist philosophy, Leggett believed in the natural right to property, not its abolition. Equal rights for all, within the limits of the General Law, and laissez-faire were the best guarantee of personal liberty. Experience taught that strong governments used their powers to enact special legislation in order to reward the wealthy and take away from the poor. "The remedy," Leggett wrote, "is easy. It is to confine government within the narrowest limits of necessary duties."

No less important to Leggett than equal opportunity in the sphere of political economy were the rights of free speech and free discussion. Here he believed government had the duty to protect such unpopular minorities as the abolitionists in their crusade against slavery. And he also espoused the right of the laboring classes to combine against the power of corporate privilege and monopoly. For the immigrants coming to America, "as the boasted asylum of the oppressed to all the world," Leggett urged a

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warm welcome rather than hostility and intolerance. Ever consistent in his attacks upon special privilege, Leggett opposed government subsidies for public works, including education, roads, and canals, as well as the protection of authors and inventors via copyright and patent laws.

White's compilation offers an attractive, readable account of Leggett's vigorous libertarian philosophy. His foreword tells the story of a brief career for which Leggett's own clear prose is the best epitaph. □

(Arthur Ekirch teaches history at the State University of New York at Albany.)

The Economist of the Country: Ludwig von Mises in the History of Monetary Thought
by James Rolph Edwards
Carlton Press, 11 W. 32nd St., New York, N.Y. 10001 • 143 pages, $7.95

Reviewed by José Italo Stelle

Young scholars intent on communicating the history and ideas of the "Austrian" school of economics to a wider audience could learn a great deal from James Rolph Edwards, Ludwig von Mises Assistant Professor of Economics at Hillsdale College.

This book deals with some crucial and forgotten aspects of monetary thought advanced early in this century by Mises. Edwards disproves the contention of some economists "that Mises made no contributions worthy of note to monetary theory and related topics which have not already been recognized by orthodox western economists and credited in their histories of monetary thought or general doctrinal histories."

Professor Edwards stresses that most mainstream economists and economic historians fail to recognize the importance of Mises as a monetary theorist because they neglect his early writings. There was a time in the 1920's when Mises was known in Vienna as "the economist of the country"—a man whose advice was sought by business and government leaders in his native Austria. But the climate of opinion shifted in the 1930's.

Mises had warned that every inflationary boom would be followed by economic collapse, but when the Great Depression came, nations turned to economic planning and Mises' work was ignored. Mises' business-cycle theory, for instance, "has been virtually forgotten, until just recently." The same has happened to his application of marginal analysis to the demand for money, one of his greatest contributions. Worse, perhaps, is the widespread belief that monetary theory "was not fully integrated with value theory until 1956," although Mises had accomplished this in 1912.

Edwards attributes "the relative obscurity" of Mises partly ". . . to the fact that *The Theory of Money and Credit* and certain of his other early works were unavailable in English translations for some decades following their initial publication."

In Edwards' technical discussion of the nature of money, the regression theorem, the value of money, and so on, he makes it clear that most critics of Mises failed to spend the time required to understand him. Their conclusions result from too hasty a consideration of the ideas of this unique "Austrian." Edwards probes the critics' half-truths, the superficially-obvious certainties, showing their logical mistakes in contrast to the truth of Mises' position.

Vindication of Mises against this background of ignorance and forgetfulness makes *The Economist of the Country* worthy of notice. □

(José I. Stelle is a free-lance writer, editor, and translator.)

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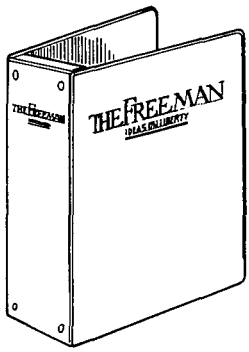

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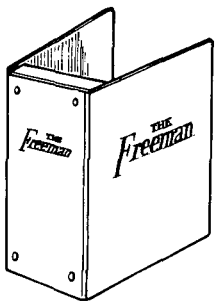

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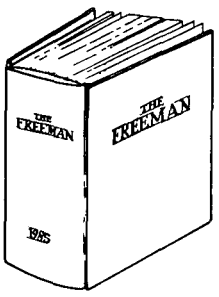

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—BRADFORD B. SMITH
"Controlled vs. Uncontrolled Economy"

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